DEPRESSION:

The Business Cycle

It is the purpose of this paper to present a summary of business cycles with emphasis on American economic depressions.

> The business cycle is a pulse common to most sectors of economic life and to various countries. Movements in national income, unemployment, production, prices and profits are not so regular and predictable as the orbits of the planets or the oscillations of a pendulum, and there is no magical methods of forecasting the turns of business activity.1

A glossary is included in the paper to assist the reader. Words followed by an asterisk (*) are defined in the glossary.

I. Definition of a business cycle

II. 1929 - 1939

  A. The Boom

  B. The Depression

III. 1929 - 1985

IV. Future prospects

  A. The next Boom

  B. The next Depression

Nothing like the Depression should ever occur again. If it does, the fault will come from unwillingness to take action, from a fixed belief in the validity of certain theories, and from a hope that what worked in an earlier generation will also work well again.

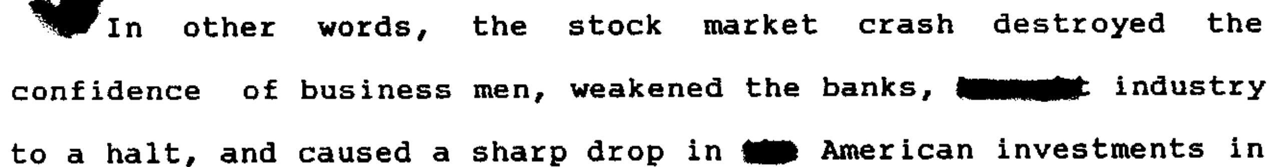
Paul A. Samuelson

The tendency of the national income* has been upward, but it has been far from steady. A test of this was done by Simon Kuznets for the years prior to 1931; this test showed that the growth rate fluctuates at about ten years. He also saw that the average time between high periods of growth was about twenty years with low times being every 22.5 years.2

The decade of the nineteen twenties, which many believed had opened a new and never-ending era of prosperity, closed in the most complete economic collapse in American history. This is very ironic considering Hoover was president of the United States at the time of the stock market crash; because when one reads a report to then President Woodrow Wilson by a senate committee chaired by then Senator Hoover in 1921 we see a description of a "typical" business cycle* as having an

> ... increased volume of manufacturing, rising stock exchange* prices followed by rising commodity prices, then by business expansion and increased demand for credit from both business men and speculators*. As the result of the advance of commodity prices, money rates stiffen and credit

> gradually becomes strained. These conditions may be accompanied by a curtailment of credit for speculative purposes. The stock exchange prices fall; for a while longer, general business continues to increase unevenly, transporation facilities are overburdened, and deliveries are delayed. The apparent shortage of goods is intensified by speculative buying and duplication of orders by merchants and other buyers until credit expansion nears its limit. Public confidence is then shaken, resulting in widespread cancellation of orders if the cycle is extreme. This is always followed by liquidation of inventories with sharp and irregular fall of prices. During the period of depression* there is always more or less widespread unemployment*.3



In other words, the stock market crash destroyed the confidence of business men, weakened the banks, industry to a halt, and caused a sharp drop in American investments in

other countries.4 The theory that a crash or a depression follows a period of prosperity is called the modern view of recurrent "business cycles"5 which states that "...a crisis is expected to be followed by a depression, the depression by a revival, the revival by prosperity, and prosperity by a new crisis."6

Thus the boom* of the roaring twenties came to an end on October 29, 1929, with the ticker tape machine over five hours behind. The day finally ended with a record 16,410,030 shares sold and a drop of the fifty leading stocks in over forty points. But this was just a small picture of what was to come, because when the stock market finally hit bottom in July of 1933, nearly thirty industrial stocks had fallen according to the Dow-Jones Index from an average of 364.9 to 62.7 dollars a share. Also a group of twenty public utilities had dropped from 141.9 to 28.0 dollars a share, and twenty railroad stocks had dropped from 180.0 to 28.1 dollars a share. In the end a total of $74,000,000,000 or five-sixths of the September 1929 value had disappeared.7

1929. That number always means a year, and that year means the crash of prices on

> the New York Stock Exchange in the last week of October. Like 1492, 1776, and 1914, the bare number 1929 has passed into the language as the term for a vivid event and the big changes it brought. The big change of 1929 was the end of the rich.8

During the next thirty years business cycles were not very clear because of Roosevelt's New Deal, World War II, and the Korean War.

One of the reforms that Roosevelt's administration brought was the Securities Act of 1933, known as the Truth-in-Securities Act, Which required stock and bond brokers to give more information than had previously been needed by the public. Another reform was the Banking Act of 1933 which made it illegal for banks to gamble on the stock market with bank funds. The Securities Exchange Act of 1934 regulated stock market trading. The Investment Company and the Investment Advisers Act of 1940 regulated investment companies and the activities of investment advisers. One of the biggest steps was the creation of the Securities and Exchange Commission (SEC). This commission is responsible for patrolling Wall Street and insuring that minimum

standards of behavior are kept.9

Because of the large army America had to raise and the financial and military aid she was required to furnish her allies during World War II, the biggest problem aside from winning the war was how to prevent runaway inflation* at home. Personal income rose as war industries offered higher wages to attract workers and as housewives, schoolchildren, and retired men and women entered factories. The war had barely started when prices jumped at a rate of two percent a month and then threatened to rise at an even faster pace in the future.

> Housing was scarce and rents shot up. No more automobiles were being made for civilians, and prices of existing cars skyrocketed. Food, clothing and all commodities began to cost more, as the public, with additional cash to spend, tried to buy what it wanted.10

In response to President Roosevelt's plea to stop this dangerous inflationary trend, Congress passed the Emergency Price Control Act.

> The Office of Price Administration

> stablized prices and established a system of rationing scarce items such as automobiles, tires, gasoline, sugar, coffee, shoes, etc. Later it "froze" most prices and rents at their levels of March 1942. Food prices were not covered, however, and they continued ti rise by 11 percent in 1942 while wages were permited to increase by 15 percent.11

It was diffucult to control inflation because various groups exerted pressure to relax controls for their benefit at the expence of others. However, the goverinment won its battle against rising prices. "From (the) spring of 1943 until the end of the war in 1945 the cost of living rose less than 1.5 percent!".12

When the war ended, the federal price control system collapsed and a series of strikes pushed prices up. "In 1950, just as it looked like prices had steadied, the Korean War broke out and costs zoomed upward again, not leveling off until 1954.13 Since then the cost of living rose gradually, averaging about 1.5 percent each year for the period from 1958 until 1964.

During the sixteen years between 1964 and 1980 a period of

creeping inflation* was seen. According to some students of economics, the memory of the 1930 depression is still so strong that many Americans accept creeping inflation without complaint. What they fail to understand is that by letting government shelve its anti-inflationary plans, there is always the danger that someday runaway inflation may replace creeping inflation and plunge the United States into another major depression.14

In order for America to meet the generally accepted criteria for a boom, she would have to have an increase of more than 4.5 percent in the physical volume of goods and services, consumer net income of more than 6 percent per year, and unemployment below 4.5 percent of the labor force.15

As governmental powers have expanded tremendously since the 1930s "...the next depression should be by far the worst in the history of the United States."16 Wage and price controls* have already been imposed; subsidy programs* have no apparent limits; welfare programs - including Social Security*, unemployment insurance, and job training programs - are far beyond anything that existed fifty years ago.

That point has been reached where national emergencies could be considered justification for anything the president might deem

necessary. Could anyone believe the president would not use every legal power at his disposal (and more) in the national emergency of a major depression? But the greatest danger of all is that the government will rely upon inflation as a tool of salvation "...it's unlikely that it would take much more inflation to bring about runaway inflation. And that is the worst kind of depression that can happen."17

NOTES

1. Paul A. Samuelson, Economics, (Tokyo: Kogakusha Company, Ltd., 1970), 251.

2. George Soule, American Economic History, (New York: The Dryden Press, 1957), 339.

3. Harold Underwood Faulkner, American Economic History, (New York: Harper and Brothers Puplishers, 1943), 638-639.

4. Adrian A. Paradis, Economics in Action Today, (New York: Julian Messner, 1967), 139-140.

5. Paradis 140.

6. Faulkner 638.

7. Faulkner 644.

8. Robert Sobel, Panic on Wall Street, (New York: The Macmillan Company, 1968), 391.

9. Gordon V. Axon, The Stock Market Crash of 1929, (New York: Mason and Lipscomb Publishers, 1974), 104-107.

10. Paradis 132.

11. Paradis 133.

12. Paradis 135.

13. Paradis 136.

14. Paradis 137.

15. Douglas Greenwald, The McGraw-Hill Dictionary of Modern Economics, (New York: McGraw-Hill Inc., 1965), 50-51.

16. Greenwald 51.

17. Harry Browne, You Can Profit from a Monetary Crisis, (New York: Macmillan Publishing Co., Inc., 1974), 64.

GLOSSARY

Boom - A rapid expansion in business activity, resulting in low unemployment, high profits, and high stock and commodity prices.

Business Cycles - Alternate expansion and contraction in overall business activity.

Creeping Inflation - Slow but persistent upward movement in the general price level of as much as 2.5% per year.

Depression - Business activity below normal, falling prices, mass unemployment, and a very high rate of business failures.

National Income - The total compensation which comes from the current production of goods and services by the national economy.

Runaway Inflation - The rapid rise of prices without limit.

Social Security - A public welfare program which seeks to reduce the threat to the economic security of the individual.

Speculators - People who assume above-average risks in the hope for above-average returns.

Stock Exchange Prices - The price an investor pays for a particular stock.

Subsidy Programs - A payment to individuals or businesses by a government for which it recieves no products or services in return.

Unemployment - Jobless persons 14 years of age and over who are out of work and would like a job even if he is doing little toward finding one.

Wage and Price Control - Government regulation of wages and prices.

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